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Bank Of Japan Reforms Short-Term Financial Markets

By most measures, Japan's monetary policy appears to be working wonderfully. The economy continues on its expansionary path while inflation appears to be firmly in check. But, risking the charge that it was tinkering with a mechanism that showed no signs of being broken, the Bank of Japan has announced changes that both liberalize financial markets and slightly alter the way the bank conducts monetary policy.

The reforms consist of three steps changing short-term financial instruments. The gradual process of introduction began November 1.

- The bank will permit trading in one- to three-week bills; its previous policy limited trading to bills of at least one-month maturity. In addition, BOJ will add these shorter-maturity bills to one- to three-month bills as major instruments of its market operations, which in turn influence the money supply. The bank hopes that using the shorter-maturity bills will give monetary policy more potency.

• The bank will buy and sell commercial paper in its market operations.

• The unsecured call-loan market maximum maturity will be greatly expanded -- to six months from the current three weeks. The availability of this additional financial instrument to borrowers and lenders is said to be in response to foreign banks operating in Japan, major borrowers in the unsecured call-loan market there.

The changes come amid indications that Japanese monetary policy is slowly tightening. While September's 10.6 percent year-to-year increase in the money supply (M_2 plus certificates of deposit) is high by historical standards, it continues a pattern of smaller year-to-year increases shown in recent months (see Table). The high rate of money supply growth has yet to stir up inflation, with the latest year-to-year figures still negative for the wholesale price index and under 1 percent for the consumer price index.

Douglas Ostrom

Money Supply Growth and Inflation

		M_2 + CDs	Overall Wholesale Prices	Consumer Prices
1981		8.9%	1.4%	4.9%
1982		9.2	1.8	2.8
1983		7.4	-2.2	1.9
1984		7.8	-0.3	2.3
1985		8.4	-1.1	2.0
1986		8.7	-9.1	0.6
1987		10.4	-3.7	0.1
1988	January	11.9	-1.0	0.9
	February	12.4	-1.0	0.7
	March	11.8	-1.0	0.7
	April	11.3	-0.7	0.3
	May	11.4	-0.5	0.2
	June	11.1	-0.6	0.2
	July	11.1	-0.9	0.5
	August	10.9	-1.0	0.7
	September(p)	10.6	-0.9	0.6

Sources: Bank of Japan and Management and Coordination Agency.

Update On Japan's Financial Liberalization

Japanese policymakers and businessmen are grappling with financial liberalization measures that could have a fundamental impact on Japan. Not only have the problems highlighted traditional lines of division, but they have

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